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No. 89-54

IN THE

Supreme Court of the United States

OCTOBER TERM, 1989

NCR CORPORATION,

Petitioner,

v.

COMMISSIONER OF REVENUE OF MINNESOTA,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE MINNESOTA SUPREME COURT

REPLY BRIEF

WILLIAM L. GOLDMAN
(Counsel of Record)
JAMES A. RIEDY
ANNE G. BATTER
LEE, TOOMEY & KENT
1200 18th Street, N.W.
Washington, D.C. 20036
(202) 457-8500

JAMES W. LITTLEFIELD
HART, BRUNER & O'BRIEN
90 South 7th Street
Minneapolis, Minnesota 55402

Counsel for Petitioner

PRESS OF BYRON S. ADAMS, WASHINGTON, D.C. (202) 347-8203

RULE 28.1 STATEMENT

A Rule 28.1 Statement is made in the Petition for a Writ of Certiorari and is still accurate.

TABLE OF CONTENTS

1. INEVITABLE INTERNATIONAL MULTIPLE TAXATION 1

2. EXTERNAL CONSISTENCY TEST 5

CONCLUSION 9

TABLE OF AUTHORITIES

CASES: Page

Container Corp. of America v. Franchise Tax Bd., 463 U.S. 159 (1983) ..... 3, *passim*

Japan Line, Ltd. v. County of Los Angeles, 441 U.S. 434 (1979) 5

Maryland v. Louisiana, 451 U.S. 725 (1981) 7

Mobil Oil Corp. v. Commissioner of Taxes, 445 U.S. 434 (1979) ..... 2 n.2, *passim*

CONSTITUTION OF THE UNITED STATES:

Commerce Clause, art. I, §8 ..... 2,4,6 n.4

Due Process Clause, amend. XIV, §1 2

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REPLY BRIEF

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1. **Inevitable international multiple taxation.** Respondent concedes (Br. Opp. 16-18)[1] for the first time in this litigation that the Minnesota apportionment formula results in international multiple taxation of Petitioner's foreign-source dividends, interest,

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[1] "Br. Opp." references are to Respondent's Brief in Opposition. "Pet." references are to the Petition for a Writ of Certiorari.

and royalties.[2] This concession firmly establishes the appropriateness of granting certiorari. As is discussed in the Petition, such international multiple taxation violates both the internal consistency requirement of the Due Process and Commerce Clauses (Pet. 18-19) and the Commerce Clause restrictions on state taxation of foreign commerce (Pet. 23-27).

In an attempt to avoid the obvious ramifications of his admission that the Minnesota apportionment formula results in international multiple taxation, Respondent argues that the internal consistency test applies without reference to foreign taxes. (Br. Opp. 16-18) This construction of the internal consistency

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[2] Respondent suggests, also for the first time, that this international multiple taxation is then eliminated by the federal foreign tax credit. (Br. Opp. 18) This suggestion makes absolutely no sense since the foreign tax credit reduces federal income taxes, not state income taxes.

Respondent also challenges whether the record supports Petitioner's statements describing the foreign taxes it paid with respect to its foreign-source dividends, interest, and royalties. (Br. Opp. 22-23) These amounts, however, are set out on schedules and statements supporting the Forms 1118 and 1120 of Petitioner's federal income tax returns. These portions of the federal income tax returns are attached to Petitioner's Minnesota returns, which were offered and received in evidence in the Minnesota Tax Court and included in the record transmitted to the Minnesota Supreme Court.

In any event, Minnesota's right to tax Petitioner's foreign-source dividends, interest, and royalties on an apportioned basis does not depend on the extent to which the foreign countries choose to exercise their primary right to tax these items. *Mobil Oil Corp. v. Commissioner of Taxes*, 445 U.S. 425, 444 (1980). Thus, Respondent's assertions as to deficiencies in the record are both factually wrong and legally irrelevant.

test is contrary to the application of that test by this Court in *Container Corp. of America v. Franchise Tax Bd.*, 463 U.S. 159 (1983). In *Container*, this Court took foreign taxes into account in applying the internal consistency test.

Respondent nonetheless argues (Br. Opp. 16) that application of the internal consistency test with reference to foreign taxes "cannot be correct, because it would be impossible to satisfy." Respondent thus acknowledges that the Minnesota apportionment formula does not satisfy the internal consistency test if the foreign taxes paid by Petitioner on its foreign-source dividends, interest, and royalties are taken into account as they were in *Container*. The test would be satisfied, however, if the formula were modified either by excluding the foreign-source dividends, interest, and royalties from apportionable income or by correlatively adjusting the apportionment factors to take into account the payroll, property, and sales of Petitioner's foreign unitary subsidiaries.[3]

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[3] Respondent repeatedly chides Petitioner for not clarifying how the apportionment factors in this case should be correlatively adjusted. (Br. Opp. 3, 4, 7, 18, 21) But Petitioner does not contend, as Respondent suggests (Br. Opp. 8), that there is only one constitutionally acceptable way to correct the Minnesota apportionment formula. Petitioner's position consistently has been only that the Minnesota apportionment formula, *as applied and upheld below*, is unconstitutional. It is true "bootstrapping" to suggest that this unconstitutionality should be permitted to continue because the aggrieved taxpayer has not solved the problem. It is Minnesota's responsibility, in the first instance, to correct its formula by choosing among a variety of options (including the exclusion of the foreign-source items from apportionable income or an adjustment of the apportionment factors). This Court need only decide whether it is unconstitutional for Minnesota to

In any event, Respondent does not challenge (Br. Opp. 19-21) the relevance of international multiple taxation when considering Commerce Clause restrictions on state taxation of foreign commerce. Instead, Respondent (Br. Opp. 19) "submits that this argument was rejected *a fortiorari* in *Mobil* and *Container* where the Court rejected foreign commerce clause arguments opposing inclusion of foreign-source income in apportionable income."

Respondent's reliance on *Mobil Oil Corp. v. Commissioner of Taxes*, 445 U.S. 425 (1980), and *Container* is clearly misplaced. *Mobil* involved an entirely different "multiple taxation" argument. Mobil argued that all of its foreign-source dividend income was fully taxable by the State of commercial domicile and, therefore, any apportionment to Vermont unavoidably subjected Mobil to the risk of multiple taxation at the state level. In deciding this Commerce Clause issue against Mobil, this Court rejected Mobil's assumption that the dividends would necessarily be subject to full taxation by the State of commercial domicile. 445 U.S. at 445-446. In so doing, this Court noted that (445 U.S. at 447):

> By admitting the power of the State of commercial domicile to tax foreign-source dividends *in full*, Mobil necessarily forgoes any contention that local duplication of foreign taxes is proscribed.

Petitioner now makes that contention. Since Petitioner's foreign-source dividends, interest, and

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include dividends, interest, and royalties in apportionable income without adjusting the apportionment factors. Once that issue is resolved, the case may be remanded to the Minnesota Supreme Court for further proceedings.

royalties were subject to foreign withholding taxes, Petitioner contends (Pet. 23-27) that *any* state taxation (even by the State of commercial domicile) of these items is unconstitutional because it "creates more than the *risk* of multiple taxation; it produces multiple taxation in fact." *Japan Line, Ltd. v. County of Los Angeles*, 441 U.S. 434 (1979). Thus, contrary to Respondent's assertion, Petitioner's international multiple taxation argument goes beyond Mobil's and, therefore, was not dealt with by this Court.

Container also is distinguishable because, on the facts of that case, this Court concluded that international multiple taxation was not inevitable. See Pet. 26-27.

2. **External consistency test**. Petitioner has contended, relying on this Court's decision in *Mobil*, that the Minnesota apportionment formula is conceptually flawed since it causes Petitioner's Minnesota taxable income to increase solely as a consequence of conducting Petitioner's foreign operations in separately incorporated subsidiaries rather than in foreign branches. See Pet. 20-22. Respondent does not dispute the factual premise of Petitioner's argument, acknowledging (Br. Opp. 9), "The form of corporate organization chosen by a taxpayer does have tax consequences." Instead, Respondent defends this result, stating (Br. Opp. 10):

> By choosing to separately incorporate its foreign subsidiaries, Petitioner has shielded their foreign income from Minnesota taxation. Petitioner should not be allowed to have its cake and eat it too by being allowed to reshape the apportionment formula to include its subsidiaries' factors.

This statement evidences Respondent's misunderstanding of both Minnesota's taxing jurisdiction and this Court's decision in *Mobil*. As this Court has repeatedly recognized, a State may not tax income earned outside its borders. Consequently, Minnesota may not tax the income earned by the activities of Petitioner's foreign branches. The inclusion of such income in the apportionable base would be unconstitutional if the branches' payroll, property, and sales were not also included in the apportionment factors. Thus, by seeking a correlative adjustment to its apportionment factors if payments from its unitary foreign subsidiaries are included in the apportionable base, Petitioner is hardly seeking to have "its cake and eat it too." Petitioner is merely seeking to avoid being penalized as a consequence of its choice of corporate organization for its foreign activities. This Court should grant certiorari to determine whether Respondent's systematic increase in Petitioner's Minnesota taxable income solely as a result of Petitioner's choice of corporate form can be squared with its decision in *Mobil*.

In countering Petitioner's external consistency argument, Respondent relies principally on the factual contention that the average increase in Petitioner's tax as a result of apportioning dividends and royalties during the five years in issue (determined pursuant to this Court's methodology in *Container*) was 23 percent. Respondent further contends (also citing *Container*) that a 23 percent increase is not sufficiently significant to warrant any factor adjustment. (Br. Opp. 3, 7, 12-13)[4]

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[4] Respondent has even gone so far as to incorporate the 23

Respondent's reliance on *Container* in this fashion underscores the importance of granting certiorari. It is important for this Court to decide whether the amount of distortion is relevant, where, as Petitioner contends (Pet. 20-23), the Minnesota apportionment formula is conceptually flawed. This is an issue not settled by this Court in *Container* because, in *Container*, the apportionment formula was found to be conceptually sound.

If the Minnesota formula is conceptually indefensible, then the State of Minnesota cannot rely on *Container* as authority to systematically overtax Petitioner year after year simply because the increase in taxation does not exceed 23 percent. Use of such a flawed formula would inevitably overstate (as Justice Stevens recognized in his dissent in *Mobil*, 445 U.S. at 461) Petitioner's Minnesota taxable income, and it is no answer at all to suggest that this inevitable, systematic overstatement was *only* 23 percent. Just as this Court "need not know how unequal [a tax] is before concluding that it unconstitutionally discriminates" (*Maryland v. Louisiana*, 451 U.S. 725, 760 (1981)), this Court need not know how distortive or inherently unreasonable an apportionment formula is before concluding that it unconstitutionally taxes extra-territorial values.

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percent figure in his statement of the Question Presented (Br. Opp. i), suggesting that the amount of distortion is responsive both to the internal consistency argument and the Commerce Clause restrictions on state taxation of foreign commerce. To the contrary, having conceded (Br. Opp. 16-18) that international multiple taxation is present in this case, the Minnesota apportionment formula must be found unconstitutional in all events even if the distortion were held not to be violative of the external consistency test.

Finally, if the extent of distortion resulting from the Minnesota formula were constitutionally relevant (as Respondent contends), the distortion in this case, *as determined under the methodology of this Court in Container*, is far greater than an average of 23 percent as Respondent persists in asserting. Nor should there be any genuine dispute at all on this point despite Respondent's assertions.[5] This point is repeated in this Reply Memorandum because Respondent has chosen to make this issue so crucial in his Brief in Opposition.

We also reiterate the need for this Court to interpret its prior decisions in *Mobil* and *Container*. As is demonstrated by the Petition and the Brief in Opposition, *both* parties rely heavily on these decisions. There is an obvious need, therefore, for this Court to clarify how its prior decisions should be applied in cases such as this.

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[5] As discussed at Pet. 10 n. 6, Petitioner filed a Petition for Rehearing in the Minnesota Supreme Court showing (pp. 8-12) that the average percentage distortion under *Container* was 31 percent, not 23 percent, and that the distortion was 40 percent or more in three of the five years and 50 percent in one year. Furthermore, contrary to Respondent's assertion (Br. Opp. 7 n. 6, 12), these calculations only reflect a distortion by dividends and royalties, and any distortion caused by the inclusion of interest in apportionable income was *not* taken into account. *All* of the assumptions used were favorable to Respondent in order to clearly demonstrate, *as a purely legal matter*, that Respondent's 23 percent figure was *not* determined in accordance with this Court's opinion in *Container*. For the convenience of the Court and to forestall any possibility that Respondent's continued persistence in relying on the 23 percent figure will dissuade this Court from granting certiorari, the Petition for Rehearing has been lodged with the Clerk of the Court.

CONCLUSION

The petition for a writ of certiorari to review the judgment of the Minnesota Supreme Court should be granted.

Respectfully submitted,

WILLIAM L. GOLDMAN
(Counsel of Record)
JAMES A. RIEDY
ANNE G. BATTER
LEE, TOOMEY & KENT
1200 18th Street, N.W.
Washington, D.C. 20036
(202) 457-8500

JAMES W. LITTLEFIELD
HART, BRUNER & O'BRIEN
90 South 7th Street
Minneapolis, Minnesota 55402

Counsel for Petitioner